1990

BJ-Titan Services Company v. Utah State Tax Commission : Reply Brief

Utah Supreme Court

Paul Van Dam; Attorney General; Brian L. Tarbet; Assistant Attorney General; Attorney for Respondent.
Maxwell A. Miller; Randy M. Grimshaw; Richard M. Marsh; Attorneys for Petitioner.

IN THE SUPREME COURT OF THE STATE OF UTAH

BJ-TITAN SERVICES COMPANY, Petitioner, vs. UTAH STATE TAX COMMISSION, Respondent.	)	Docket No. 900368 Priority Category 15

ON APPEAL FROM THE UTAH STATE TAX COMMISSION

REPLY BRIEF OF PETITIONER

PAUL VAN DAM (#3312)
Attorney General
State of Utah
BRIAN L. TARBET (#3191)
Assistant Attorney General
State of Utah
Attorney for Respondent
Utah State Tax Commission
130 State Capitol Building
Salt Lake City, Utah 84114
Telephone: (801) 533-7661

MAXWELL A. MILLER (#2264)
RANDY M. GRIMSHAW (#1259)
RICHARD M. MARSH (#4088)
of and for
Parsons Behle & Latimer
Attorneys for Petitioner
BJ-Titan Services Company
185 South State Street
Salt Lake City, Utah 84147
Telephone: (801) 532-1234

IN THE SUPREME COURT OF THE STATE OF UTAH

BJ-TITAN SERVICES COMPANY, Petitioner, vs. UTAH STATE TAX COMMISSION, Respondent.	)	Docket No. 900368 Priority Category 15

ON APPEAL FROM THE UTAH STATE TAX COMMISSION

REPLY BRIEF OF PETITIONER

PAUL VAN DAM (#3312)
Attorney General
State of Utah
BRIAN L. TARBET (#3191)
Assistant Attorney General
State of Utah
Attorney for Respondent
Utah State Tax Commission
130 State Capitol Building
Salt Lake City, Utah 84114
Telephone: (801) 533-7661

MAXWELL A. MILLER (#2264)
RANDY M. GRIMSHAW (#1259)
RICHARD M. MARSH (#4088)
of and for
Parsons Behle & Latimer
Attorneys for Petitioner
BJ-Titan Services Company
185 South State Street
Salt Lake City, Utah 84147
Telephone: (801) 532-1234

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

CASES

RULES

STATUTES

OTHER AUTHORITIES

I. UNDER THE UTAH ADMINISTRATIVE PROCEDURES ACT, LEGAL ISSUES ARE REVIEWED DE NOVO WITH NO DEFERENCE TO THE AGENCY'S DECISION.

As this proceeding was initiated after January 1, 1988, the Administrative Procedures Act ("APA") applies. Pursuant to Utah Code Ann. § 63-46b-16(4)(d), BJ-Titan Services Company ("BJ-Titan") appeals the Utah State Tax Commission's (the "Commission") Findings of Fact, Conclusions of Law and Final Decision, issued July 2, 1990 ("Final Decision"), on the grounds that the Commission has "erroneously interpreted or applied the law" as to the first three issues presented in this proceeding.[1] These issues are legal issues: specifically, whether services rendered by BJ-Titan, and the transfer of motor vehicles to BJ-Titan, are subject to sales taxation under the provisions of the Emergency Revenue Act of 1933 (the "Act") (Utah Code Ann. §§ 59-15-1 et seq. (1985)).[2] The underlying facts in this case are not in dispute; rather, the proper construction of the sales tax statute and the interpretation of existing case law will determine the taxability of these transactions.

The well established standard for reviewing an agency's decision based on a legal issue, as applied to both pre- and post-APA cases, is de novo with no deference to the agency's decision. For instance, the Utah Court of Appeals in Bevans v.

---

[1] I. Whether services provided by BJ-Titan were incidental to the sale of tangible personal property?
II. Whether BJ-Titan is a real property contractor?
III. Whether the transfer of motor vehicles to BJ-Titan qualifies as an isolated or occasional sale?

[2] Now codified in Utah Code Ann. § 59-12-101 et seq. (1987) (as amended (Supp. 1990)) and known as the Sales and Use Tax Act.

Industrial Comm'n of Utah, 790 P.2d 573 (Utah Ct. App. 1990), applying post-APA law, cited with approval the official comment to the 1981 Model State Administrative Procedures Act, Section 5-116(c)(4), as follows:

> [W]ith regard to an administrative agency's interpretation of the law, the comment states, "courts generally give little deference to the agency, with the result that a court may decide that the agency has erroneously interpreted the law if the court merely disagrees with the agency's interpretation."

Id. at 575 (emphasis added).

The Court of Appeals went on to state:

> We conclude that, under section 63-46b-16(4)(d) of the UAPA, it is still appropriate for a court to review an agency's interpretation of its statutorily granted powers and authority as a question of law, with no deference to the agency's view of the law.

Id. at 576 (emphasis added).

The Commission cites to Boyd v. Dept. of Employment Sec., 773 P.2d 398 (Utah Ct. App. 1989) for the proposition that some weight should be given to the Commission's Final Decision. As set forth in Boyd:

> While "[a]n agency's interpretation of key provisions of the statute it is empowered to administer" should be given due weight, . . . if that agency has "misconstrued or misapplied" the statute "it is the duty of the court to correct the same."

Boyd at 400 (emphasis added, citations omitted). However, Boyd does not stand for the proposition that an agency's decision is automatically given weight. Boyd sets forth that it is only the agency's interpretation of key provisions of a statute which may be given consideration. In the present case, with respect to the

services issue, there are no statutory terms or provisions in the Act to be interpreted. Only those services specifically listed in the Act are subject to sales taxation. Clearly absent from the Act is any reference to well stimulation services of a type performed by BJ-Titan. Any authority to tax BJ-Titan's services evolves from Utah case law which provides that services incidental to the sale of tangible personal property are subject to sales taxation.

As explained in Hurley v. Board of Review of the Industrial Comm'n of Utah, 767 P.2d 524, 528 (Utah 1988), it is the courts, not administrative agencies, who have the expertise to construe statutes and decide legal issues.

> The facts here are not in dispute. Nor is there dispute about the application of the law to the facts. The real dispute is solely, what does the law require? Specifically, the issue is, when does the 52-week eligibility period begin to run under 19 U.S.C. § 2293(a)(2)? That is a straightforward issue of statutory construction. Resolution of the issue would not be aided by agency expertise, and no term of art is at issue. Indeed, it is the courts that have expertise in matters of this nature, not an administrative agency. See Dean Evans Chrysler Plymouth, 692 P.2d at 782. Of course, the statute and regulations, once properly construed, must be applied to the facts of the case, but that does not make the issue one of mixed law and fact. There is, in short, no reason to accord the Board a zone of reasonableness in its construction of the law. The Board either read the statute and regulations correctly, or it did not.

The Commission also cites to First N'l Bank of Boston v. County Board of Equalization, 145 Utah Adv. Rep. 8 (October 16, 1990) that the substantial evidence standard of review should be applied to the Commission's findings of fact under Utah Code

Ann. § 63-46b-16(4)(g). In First N'l Bank of Boston the "only issue for review [was] the accuracy of the Tax Commissions findings of fact" (Id. at 8); therefore, the substantial evidence test was appropriately applied in that case. Likewise, the substantial evidence test should apply to the fourth issue in this proceeding.[3] However, the substantial evidence test does not apply to legal issues and therefore is not applicable to the other issues in this proceeding.

II. THE UNDERLYING FACTS ARE NOT IN DISPUTE.

The basic underlying facts in this case - the services BJ-Titan performs, the materials used, the technology and expertise required, the proportion of services to materials furnished, etc. - are not in dispute. These facts are clearly reflected in the record developed at the Formal Hearing. The Commission's Findings of Fact, in large part, are reflective of the factual record. However, the Commission makes several conclusory findings from the facts to which BJ-Titan objects.[4] BJ-Titan has addressed these objections in its Brief.

---

3 Is there substantial evidence to support the Commission's finding that the "aggregate rule" for taxing the transfer of motor vehicles did not exist?

4 For example, Finding of Fact #14 where the Commission concludes: "Thus it is the well operators (customers of BJ-Titan) that convert the materials (cement) acquired from BJ-Titan into real property"; or Finding of Fact #15 where the Commission concludes: "The cementing services of BJ-Titan are similar to a ready mix concrete company that sells concrete to a building contractor and pumps it to the location where it is needed by the contractor." Record ("R.") 56-57.

III. THE COMMISSION ERRONEOUSLY INTERPRETED THE LAW.

A sales tax is levied on every sale of tangible personal property. Utah Code Ann. § 59-15-4 (1985). However, only those services specifically identified in Section 59-15-4(b)-(g) are subject to sales taxation. Absent from Section 59-15-4(b)-(g) is any reference to well stimulation services of a type rendered by BJ-Titan. Accordingly, these services are not subject to taxation, unless they are rendered incidental to the sale of tangible personal property.[5] The test, and appropriate inquiry, is whether the services BJ-Titan renders are incidental to the sale of tangible personal property. Moreover, in making this inquiry, the applicable law must be broadly construed in favor of BJ-Titan because BJ-Titan is not seeking an exemption from sales taxation,[6] but contests that the services it renders fall outside the scope of property or services subject to taxation under the Act.

In BJ-Titan's case, the proper inquiry was not made. In its Final Decision, the Commission, using an erroneous standard, concluded that well stimulation services were taxable because they were "a necessary component of the final product and is [sic] taxable." R. 60. The Commission has confused "necessary" with "incidental." Services are taxable only when incidental, not necessary, to the sale of tangible personal property. The Commission continues this erroneous construction of the law

---

[5] Butler v. State Tax Comm'n, 13 Utah 2d 1, 367 P.2d 852 (1962) and Western Leather & Finding Co. v. State Tax Comm'n, 87 Utah 227, 48 P.2d 526 (1935).

[6] Parson Asphalt Products Inc. v. State Tax Comm'n, 617 P.2d 397 (Utah 1980).

in its Brief: "The services that BJ-Titan provides to its customers in the sale of these products is a necessary component of these products and is thus taxable." Commission Brief at 11-12 (emphasis added).

BJ-Titan agrees that the services it renders are necessary to well stimulation, just as an orthodontist's or dentist's services are necessary to correcting an overbite or crowning a tooth, but that is not the test. Necessary is not incidental. Until the Commission recognizes this distinction, it will continue to erroneously interpret the applicable law.

For example, the Commission states that "all services which are rendered in connection with the sale of tangible personal property are subject to sales tax."[7] This statement is not correct. The Act imposes a sales tax only on those services which are specifically set forth in the statute. Under case law, those services which are incidental to the sale of tangible personal property are also taxed. All services falling outside the scope of these two areas are not subject to sales taxation.

BJ-Titan went to great lengths to establish in the record the substantial nature of the services it renders, both in terms of total invoice cost and the expertise and technology involved in the well stimulation process. The record reflects that these services are not incidental to the sale of tangible personal property. For this reason, in the Final Decision there

---

7 Commission Brief at 15 (emphasis added); and "Section 59-15-4 and the corresponding tax regulations, taken as a whole, evidence that all services which are rendered in conjunction with the retail sale of tangible personal property are subject to sales tax." Id. at 16 (emphasis added).

are no specific findings or conclusions that services rendered by BJ-Titan ~~are~~ incidental.

The Commission argues that BJ-Titan "exaggerates" its technical expertise because it relies on information provided by the well operator such as well logs, drilling records, etc. Commission Brief at 18. This reasoning is without merit for a number of reasons. First, it contradicts the specific findings of the Commission: "Without the expertise of the employees of the Petitioner, the raw chemicals or cement are of little value to the well operators. . . ." R. 55. Second, it also contradicts a statement quoted by the Commission in the preceding paragraph of its Brief: "the product's usefulness depends upon proper installation and the person selling that product [BJ-Titan] is usually the one possessing the necessary knowledge and skill to deliver the product and assist in putting the product into operation." Commission Brief at 17-18 (emphasis added).[8]

IV. MCKENDRICK IS DISTINGUISHABLE AND THUS NOT APPLICABLE.

Because the Commission was unable to conclude that BJ-Titan's services are "incidental," it has attempted to characterize BJ-Titan as a manufacturer of tangible personal property under the rationale of McKendrick v. State Tax Commission, 9 Utah 2d 418, 347 P.2d 177 (1959). In its Brief, BJ-Titan explains why McKendrick is distinguishable and thus not applicable to the

---

[8] Moreover, the Commission's reasoning disregards the economic realities of the transaction. The Commission did not consider that the parties are unrelated and dealing at arm's length. Thus, BJ-Titan's billings for services rendered at 200% of the cost of materials demonstrate that the services rendered were considered to be substantial by BJ-Titan and its customers.

present facts. The Commission's Brief does not respond to BJ-Titan's arguments that these well stimulation services do not involve the manufacture of a finished product; i.e., "the process of transformation through various stages [wherein] the value [of the finished product] is steadily enhanced in proportion to the expenditure of time, energy and skill thereon." McKendrick at 178 (emphasis added). No response is possible, because for McKendrick to be applicable, there must be the synthesis of both services and materials into the finished product. Id. McKendrick taxed the entire sales price of the prosthetic device because the labor provided was directly incorporated into the finished product such that the finished product, as a direct result of that labor, "acquired the value created by such skill and labor." Id. at 177. The finished product was then sold to third parties.[9]

In BJ-Titan's case, the services it performs are not directly incorporated into a finished product. BJ-Titan is retained and compensated for its knowledge, expertise and services rendered in the placement of cement or chemicals in certain critical zones of the well bore. The cement, is nothing but cement, before and after placement. If one could extract it, and reuse it, it would only be worth the cost of cement. There is no

---

9 This Court emphasized that point in Tummurru Trades, Inc. v. Utah State Tax Commission, 143 Utah Adv. Rep. 5 (September 19, 1990), when it distinguished real property contractors from manufacturers, because real property contractors synthesize labor and material into a final product which becomes realty, whereas manufacturers synthesize labor and materials to produce a finished product (other tangible personal property) which is then held for resale. Id. at 7.

proportionate increase in the value of the cement itself as a result of the services BJ-Titan renders. BJ-Titan does not create a finished product which is then held for resale. BJ-Titan is not a manufacturer; therefore, McKendrick is not applicable.

V. NO FINISHED PRODUCT IS CREATED IN ACIDIZING AND FRACTURING SERVICES.

With respect to BJ-Titan's acidizing and fracturing services, there is likewise no manufacture or production of a finished product proportionately more valuable in relation to services performed thereon. The fact is that there is no finished product manufactured. Chemicals are injected into a well to stimulate well flow. Moreover, in acidizing and fracturing services, the chemicals used represent an even smaller percentage of the total contract price.

The only statement the Commission makes with regard to fracturing and acidizing services is that they do not become part of the real property. This argument relates to the real property contractor issue and does not explain why, or how, or even if, the Commission made a determination that these services were incidental to the sale of tangible personal property. Clearly, where BJ-Titan performs an acidizing or fracturing job, it is not selling tangible personal property, but is retained to perform a service; i.e., to stimulate the well.

VI. HARDY IS AN APPROPRIATE ANALOGY.

Contrary to the Commission's argument, Hardy v. State Tax Commission, 561 P.2d 1064 (Utah 1977) is the appropriate precedent because the legal test followed in that case demonstrates the existing law in Utah. The Commission argues that all

services rendered in connection with the sale of tangible personal property are subject to a sales tax. Hardy shows this statement to be incorrect. In Hardy, the dentist transferred tangible personal property which was held to be subject to sales tax, but the services rendered thereto were not taxable because they were not incidental. The Commission correctly notes that the Court in Hardy accepted the fact that the services rendered were substantial. Being substantial, they were not subject to tax even though tangible personal property was being transferred and that property was subject to sales tax. BJ-Titan draws the same analogy and concludes its services are likewise substantial and should be excluded from the scope of taxation even though a sales tax is imposed on the property transferred in conjunction with that service.

The analogy to a dentist, orthodontist or any other service oriented practice which includes the transfer of tangible personal property is appropriate. In these professions, as in the well stimulation industry, the "essence of the transaction" or the "true object" of a customer is to retain the services of the professional, and have that professional render his expertise to achieve a specific, and usually technically difficult, result. In Mark O. Haroldsen, Inc. v. State Tax Comm'n, 148 Utah Adv. Rep. 26, 29 (November 27, 1990) this Court stated:

> [T]his Court has twice used the essence of the transaction test in considering whether the tangible materials used or the personal services rendered in a transaction constituted the essence of the transaction.

If the true object of the transaction was the cement or chemicals, the well owner could purchase those materials itself (and save 200% of the cost). The record clearly shows the essence of the transaction is not the acquisition of the materials themselves, but the retention of BJ-Titan's expertise and abilities to achieve enhanced well flow through the specialized and sophisticated placement of chemicals or cement in critical zones of the well bore. Because the essence of the transaction is the services being rendered, these services are not incidental to the sale of tangible personal property and are not subject to taxation.

The Commission distinguishes the above analogy on the basis that the dentist makes his own diagnosis and then treats the patient, whereas BJ-Titan, at times, relies on the well operator to supply information regarding a particular well. This rationale loses focus on the fact that the sales tax is imposed on the tangible personal property being transferred and incidental services rendered thereto. Immaterial to this inquiry is whether an individual does his own diagnosis, or relies on records of others. The important fact is that the dentist, as BJ-Titan, is the party who has the technical expertise to assimilate diagnostic data and actually performs a sophisticated task to accomplish a specific result. The focus is on what services are actually rendered, and are they incidental to the transfer of tangible personal property. If the essence of the transaction is the rendition of technical expertise in the form of services, those services are not incidental. As in Hardy, the services

rendered by BJ-Titan were substantial and the essence of the transaction, and should not be taxed.

VII. BJ-TITAN IS A REAL PROPERTY CONTRACTOR.

In its Brief, the Commission sets forth various reasons why BJ-Titan is not a real property contractor. First, the Commission states that the manner in which BJ-Titan reported sales taxes should be determinative as to how it is taxed. Commission Brief at 24. Second, the Commission argues that "BJ-Titan's oil and gas well stimulation operations do not consist of converting taxable personal property into real property." Id. Third, the Commission argues that because BJ-Titan's contracts set forth that BJ-Titan is under the "direction, supervision and control of the owner" that BJ-Titan cannot be a real property contractor. Id. Finally, the Commission argues that it is the well operator who is the real property contractor because the "well operator is in large part responsible for the physical placement of chemicals and cement into the well." Id. at 25.

As to the first argument (manner of payment), to follow the form of a transaction while ignoring its substance is contrary to established legal precedent. As summarized by the United States Supreme Court in Gregory v. Helvering, 293 U.S. 465, 470 (1935) (a landmark tax case repeatedly cited for the proposition that form should not be elevated over substance), "to hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose."

As to the second argument (that BJ-Titan's operations do not consist of converting tangible personal property into real property), the Commission already made the following specific findings:

> 5. Cementing involves the placement of various cementing compositions, fluids, and slurry compositions, into various places in the well.
>
> 9. Without the expertise of the employees of the Petitioner, the raw chemicals or cement are of little value to the well operators . . . .
>
> 11. The customer is purchasing the final product in the hole where it has its only value to the customer. The final product has value to the customers of BJ-Titan only after the materials and services together have been provided to the customers [i.e., the placement of the cement or chemicals in the well].
>
> 13. Concerning cementing services, BJ-Titan synthesizes materials and services to provide a finished product which stabilizes the pipe located in the well. Once poured, the cement cannot be removed. The cement permanently affixes the casing to the surrounding hole and becomes real property.

R. 54-56 (emphasis added).

These findings show that BJ-Titan converts tangible personal property (the cement) into real property. The arguments now raised by the Commission, that BJ-Titan's operations do not convert tangible personal property into real property, or that it is the well operator who actually converts the cement into realty, are contrary to the Commission's own findings and the underlying record.

The record clearly establishes that well stimulation services are technical and sophisticated, and can only be

accomplished by those trained to do so using specialized equipment.[10] BJ-Titan has this technical expertise and specialized equipment. The well owner does not have the expertise, nor the equipment, to perform well stimulation services.[11] For these reasons, the customer never performs any of the services.[12]

---

10 Tr. 76 (Testimony of Mr. Cramer):

> Q (By Mr. Miller) Mr. Cramer, do the oil well owners have the expertise to perform these services for themselves?
>
> A No. Specialized equipment is necessary, and other technical guidance is very necessary. It's a very specialized business.

Tr. 79 (Testimony of Mr. Cramer):

> So it requires a lot of knowledge about the formation. You may adequately stimulate a sandstone with an acid treatment. You may destroy it also. . . . And, again, a lot of chemical understanding needs to go into every acidizing treatment. You need to get samples of the oil from that well or nearby well. You have to know about the formation.

Tr. 71-72 (Testimony of Mr. Cramer):

> A lot of technique has to go into every single job. . . . You have to use various techniques that are going to vary with each individual formation to accomplish this.

11 Tr. 144 (Testimony of Mr. Cramer):

> Q Could your customers perform a cementing operation without your equipment?
>
> A No.
>
> Q Could they do it without the expertise that you also provide?
>
> A No.

12 Tr. 92 (Testimony of Mr. Cramer) (emphasis added):

> Q (By Mr. Miller) One more redirect on that. When you talked a moment ago about BJ-Titan Services' policy, does the customer at any time perform any of these services physically?
>
> A (By Mr. Cramer) No.

Accordingly, BJ-Titan is the last party (because it is the only party) to deal with the materials before placement into the well. BJ-Titan consumes and converts tangible personal property into realty.

Despite this uncontroverted evidence, the Commission argues that it is the well operator that converts the materials into real property. The Commission states that the "transcript is replete with testimony indicating that the well operator is in large part responsible for the physical placement of chemicals and cement into the well." Commission Brief at 24-25 (emphasis added). This statement is not correct. The only function the well operator performs in the physical placement of chemicals or cement into the well is the preparatory and ministerial tasks of attaching some, not all, mechanical devices to the string, and lowering the string into the well.[13] Thereafter the physical placement of cement or chemicals is done by BJ-Titan.

It must be recognized that the most important and critical aspect of well stimulation operations is the injection process. That is when critical decisions have to be made based on the monitoring and feedback of the injection process.[14] The

---

[13] Even when the well operator attaches these devices, it is done under the supervision of BJ-Titan. "There are guide shoes, float collars, centralizers, mechanical aids in the cementing process that are supplied by us that [sic] we have supervisors out there to make sure that they are installed properly." Tr. 85 (Testimony of Mr. Cramer) (emphasis added).

[14] "A lot of these decisions are made on location. There are changes that are made based on the pressure response. I have a slide here later which shows treatment monitoring. A lot of on-the-fly decisions that are made in

Footnote continued on next page.

record reflects that the entire physical installation of materials is done by BJ-Titan, and that this is the critical task in the injection process.

The Commission has not followed the appropriate test or made the relevant inquiry in this case. The test does not focus on contractual provisions, or the manner in which sales taxes are reported, but rather on the substance of what is taking place. Specifically, as stated by this Court in Utah Concrete Products Corp. v. State Tax Commission, 101 Utah 513, 125 P.2d 408, 410 (1942):

Footnote continued from previous page.

order to get the desired result, which is an increased well bore ratings." Tr. 78 (Testimony of Mr. Cramer).

"Now, during the job the cement operator is looking to his pressures, he has a pressure gauge which monitors this pressure, the injection pressure down the hold. And they're also monitoring the turn rates." Tr. 93 (Testimony of Mr. Cramer).

"And if either one of these parameters may change, we may do something different to more expediently accomplish this feat. We may from that feedback information increase our rates. If we don't increase our rates, we may not get this test. We may decrease our rates, depending on the technical knowledge and experience of the cementing operator out there. . . ." Id.

"This just shows the control headquarters, and there are quite a number of cement jobs. More and more we're actually running jobs from a control van. You can see the numerous gauges that these people are looking at during a treatment. And the numerous things they are controlling a lot of them -- they're controlling surfactants [sic] additions continuously, cross-linking agents, sands." Tr. 140 (Testimony of Mr. Cramer).

"They're monitoring that with nuclear densimeters, with optical encoders. You can see the walkie-talkie communication headsets. They are in constant communication with their people throughout the whole job, getting feedback from them." Id.

"There are a whole series of duplicate double checks during a job to make sure that we are actually pumping what we want to pump, that we are actually getting accurate feedback." Id.

> The paramount question then turns upon the proposition of whether the contractors to whom plaintiffs sold their products were "users" or "consumers" within the meaning of the act or whether they were mere dealers in the product's reselling to the third parties.

Clearly, BJ-Titan is the consumer of the cement, for it is BJ-Titan that performs the service to place that cement in the well. BJ-Titan purchased the raw materials "not for reselling them as such in their original form, but for the purpose of changing their very nature from personal to real property." Tummurro Trades at 7 (citing Utah Concrete). As Mr. Anderson testified, BJ-Titan is a real property contractor because "they [BJ-Titan] are performing the labor that converts this cement into its final product or form. In other words, you don't have the owner of the well coming out and doing additional things to that cement after it's poured." Tr. 177.[15]

The Commission incorrectly argues that BJ-Titan falls within the scope of McKendrick.[16] Yet the Commission cannot consistently argue that BJ-Titan synthesized labor and materials, making it subject to tax on the full purchase price under McKendrick's rationale, and then ignore that rationale to avoid a conclusion that BJ-Titan is a real property contractor under the

---

15 The Commission offers the testimony of Mr. Ashcroft, an auditor and employee of the Commission, who concluded that BJ-Titan was not a real property contractor based on his rhetorical question: "So how can you say that they [BJ-Titan] are indeed installing the cement, when in actuality it appears that all they're doing is delivering it to the job site and pumping that cement down the well." Tr. 214. The uncontroverted record (see footnote 14 supra) demonstrates the fallacy of Mr. Ashcroft's rhetoric.

16 "McKendrick disposes of the issue in the present case." Commission Brief at 20.

rationale of Utah Concrete. To so conclude is arbitrary and a clear abuse of agency discretion.

Finally, to conclude that BJ-Titan is not the real property contractor because of certain contractual provisions, once again ignores the substance of the relationship between BJ-Titan and the customer. As in any transaction, where one party is performing work for another, the customer always has the ultimate authorization as to how, when, where, etc. a project is conducted. Equally so, in the present case, the contractual terms reflect that the customer has the right to direct what, how or when something is to be done, but the right to control does not translate into ability or actual performance. Nor does the Act impose a sales tax liability on the well owner because he supervises or directs construction of a project. It is the party who actually performs the service who is considered the real property contractor. While recommendations are made to the customer, who may even have an understanding of the technology, and who may even participate in the development of what is to be done, once the customer approves a given recommendation, BJ-Titan is exclusively responsible for implementation of that recommendation.[17] If anything goes wrong it is BJ-Titan who is fiscally responsible for damage to a well, not the well owner.

---

17 "They're going to discuss the job procedure, and then the customer turns over the performance of the cementing job to us. He doesn't get up there and run the cement trucks. He doesn't have the talent or the skills to do that, or the experience, or if he does, he wouldn't be allowed to anyway, because it's strictly against our policy. Only BJ-Titan people can--are allowed to operate this equipment." Tr. 89 (Testimony of Mr. Cramer).

VIII. ISOLATED OR OCCASIONAL SALE

~~A.~~ The Isolated Or Occasional Sale Provisions are an Exception, Not Exemption, to Taxation. The distinction between an exception and an exemption from taxation is very important as to the broad or narrow construction of the applicable law to be given by the courts. The Commission repeatedly refers to the isolated or occasional sale provisions as an exemption, see Commission Brief at 28, and argues for a narrow construction of its terms in favor of the Commission. Id. at 35.

While the isolated or occasional provisions are an exemption from sales taxation under present law (see Utah Code Ann. 59-12-104(14) (1990)), under the law as in effect in 1985, the isolated or occasional sale provisions were an exception to the definition of a "retail sale" set forth in Utah Code Ann. § 59-15-2(5) (1985) and thus an isolated or occasional sale was not subject to tax. The business reorganization provisions are likewise found in Section 59-15-2(5) (1985) and set forth that motor vehicles transferred in a business reorganization qualify as an isolated or occasional sale. Accordingly, these statutory provisions "should generally be construed favorable to the taxpayer and strictly against the taxing authority. . . ." Parson at 398 (citation omitted).

B. No Sale Took Place. The Act provides for a tax on the retail sale of tangible personal property. For a tax to be imposed, there must be a sale. BJ-Titan argues that no sale has taken place in the transfer of motor vehicles to BJ-Titan in conjunction with the formation of the partnership. Rather, this was

a non-taxable (as it is for federal and state income tax purposes) contribution to capital on the formation of a new entity.

Other jurisdictions have similarly held that no sales tax applies on the transfer of assets to a newly organized entity for a lack of consideration.[18] The Commission likewise acknowledges that "arguably there was never a sale of an 'entire business' but only a transfer of certain assets to a newly formed partnership . . . ." Commission Brief at 28. Yet the Commission's only response is to state that "the vehicles transferred by BJ Hughes and Titan Services were evidently an exception to the isolated or occasional sale and hence subject to Utah sales tax." Id. However, BJ-Titan is not arguing that the transfer of motor vehicles qualifies as an isolated or occasional sale, but that no sale took place. Thus the transfer should be treated as a non-taxable transaction for sales tax purposes, as it is treated for income tax purposes.

C. The Vehicles Transferred to BJ-Titan Were Not of a Type Required to be Registered. Utah Code Ann. § 59-15-2(5) (1985) provides that the transfer of vehicles "of a type required to be registered under the provisions of the motor vehicles laws shall [not] be deemed isolated or occasional." Likewise, Rule

---

18 See IBEC Industries, Inc. v. Lindley, 405 N.E.2d 289 (Ohio 1980) (the reorganization of a corporation by contributing the assets and liabilities of a division in exchange for stock of a newly formed subsidiary is not a taxable sale for lack of consideration); and Roberts & Sons, Inc. v. Kosydar, 330 N.E.2d 437 (Ohio 1975) (transfer of partnership assets, including motor vehicle registered in the name of one of the partners but used in partnership business, to newly-formed corporation where shareholders maintained same percentage ownership as in partnership held not a taxable sale for lack of consideration); see also Northern Telecom Inc. v. Olsen, 679 S.W. 2d 488 (Tenn. 1984).

38S provides that "vehicles required to be titled or registered" (emphasis added) are not isolated or occasional sales. BJ-Titan's vehicles are not subject to registration pursuant to the provisions of Utah Code Ann. § 41-1-19(1)(a) because the motor vehicles are "of a type" described in paragraph (1)(a) which are excepted from registration.

The Commission argues that Section 59-12-2(5) is concerned "with the classification of vehicles for imposition of state sales tax, not whether the vehicles are actually registered in the state of Utah." Commission Brief at 29. BJ-Titan agrees. The transfer of motor vehicles to BJ-Titan should be treated as an isolated or occasional sale, not because the vehicles are titled in Texas as opposed to Utah, but because the classification set up by Utah Code Ann. § 41-1-19 excepts BJ-Titan's motor vehicles from registration.

The Commission cites Utah Code Ann. § 41-1-19 for the proposition that all vehicles are subject to registration as follows:

> (1) Every motor vehicle, combination of vehicles, trailer, and semitrailer when driven or moved upon a highway is subject to the registration and certificate of title provisions of this chapter. . . .

Commission Brief at 29. Conveniently absent from this citation is the final word of paragraph (1); i.e., "except". The omitted word introduces nine classifications of vehicles "of a type" not required to be registered in Utah. Under the Commission's interpretation, all vehicles would be excluded from the definition of an isolated sale because all vehicles are "of a type" required to

be registered. There would be no exceptions. If other states were to adopt this rationale, they could also impose a tax on BJ-Titan on the transfer of vehicles because these vehicles operate in multi-states. Using registration as a qualifier, this avoids multiple taxation of the same transaction by various states.

D. Business Reorganization Exception. BJ-Titan argues that the transfer of motor vehicles was done pursuant to a "business reorganization where the ownership of the transferee organization is substantially the same as the ownership of the transferor organization." Section 59-15-2(5). The Commission held that the ownership of the transferee corporation was not "substantially the same" as the transferor corporation. R. 63. At issue then is what level of continuing ownership in the new organization, following a "business reorganization", constitutes substantially the same. For a statutory merger or consolidation[19] to qualify as an reorganization, the continuity of ownership in the new organization need only be a "majority." Utah Code Ann. § 59-7-115(9)(a). Yet, the Commission is unwilling to look to the Utah income tax statues for a definition of "substantially the same" ownership in business reorganization, and suggests that the Court look instead to federal income tax provisions. The rationale behind this suggestion is confusing because Utah has adopted and follows the federal provisions. The

---

19 As discussed in BJ-Titan's Brief at 41, the Commission technically ruled that the transfer of vehicles to BJ-Titan was a consolidation; i.e., two entities transferring assets to form a new entity.

error is that the Commission wants "substantially the same" ownership in a business reorganization to be 80% because that is what Mr. Cook said the IRS uses. Tr. 241. Unfortunately, Mr. Cook is wrong. Pursuant to I.R.C. §368(a)(1)(A), which is the federal statutory provision for statutory merger and consolidation reorganizations, the I.R.S. follows the same majority requirement for continuity of ownership interest.[20]

E. Substantial Evidence Demonstrates That The Commission Followed an Aggregate Rule. Mr. Anderson's testimony, Mr. Cook's admissions, and the documentary evidence provided at the Formal Hearing clearly show that until 1986, the Commission followed a policy of taxing the transfer of motor vehicles to partnerships on the aggregate basis. Tr. 159-160; Exhibit 5, R. 226-7; and Exhibit 6, R. 228-40. Following an advisory opinion letter from the Utah Attorney General's Office, the Commission changed that policy, and adopted the entity approach which it is now imposing on BJ-Titan.

This change in policy (or adoption of a new policy) in 1986, and its application to BJ-Titan, is improper and illegal for failure to comply with the provisions Administrative Rulemaking Act which in 1986 provided (Section 63-46a-3(3)(1986):

> (3) Rulemaking is required when:
>
> (a) agency actions affect a class of persons;

---

20 See I.R.S. Rev. Proc. 77-37, 1977-2 C.B. 568 which indicates that the I.R.S. will issue a favorable ruling that a transaction qualifies as a reorganization under I.R.C. § 368(a)(1)(A) if, among other requirements, the prior owners [the transferors] continue to own 50% or more of the equity in the new entity [the transferee].

(b) agency actions affect the operations of another agency; or
(c) statutory or federal mandate requires rules.

Adoption of the entity rule constitutes agency action which affects a class of persons. The Commission failed to follow prescribed rulemaking procedures before implementing the entity test. Contrary to law, the "entity" test was adopted on an ad hoc basis by Commission personnel. Tr. 241.

In response, the Commission argues that no policy or rule ever existed because these was nothing in writing, only an informal policy. However, according to Section 63-46a-2(8)(a) (1986), there is no requirement that a rule or policy be written. As long as the agency action applies to a general class of persons, and implements or interprets policy made by the statute, it constitutes a rule. The result suggested by the Commission is not proper. Just because a policy is not in writing does not prevent that policy from having the effect of a rule. If so, the Commission could adopt any policy it chooses, force it upon Utah taxpayers as a rule, but avoid rule-making procedures by never reducing the policy to writing. Regardless of whether the policy was unwritten, informal or otherwise, the fact remains that the Commission is applying the entity test to taxpayers without having adopted that policy through valid rulemaking procedures.[21]

Finally, the Commission argues that even if it had adopted such a rule, BJ-Titan failed to rely upon it to its

---

21 See Williams v. Public Service Commission, 720 P.2d 773 (1986) (where this Court held certain actions of the PSC constituted a de facto rule).

detriment. This policy is now being forced upon BJ-Titan to its detriment. It is an improper and illegal policy of the Commission which does not become legitimized because a taxpayer failed to take any previous action in reliance thereto. There is no requirement of reliance, and BJ-Titan is not prohibited from contesting the legality of a rule being applied to it. BJ-Titan appropriately raised the issue before the Commission, and is entitled to contest its impropriety.

IX. CONCLUSION

BJ-Titan is engaged in the business of providing well stimulation services. The essence of its service transactions are to obtain enhanced well flow. These services are substantial in nature and are not incidental to the sale of tangible personal property. Additionally, because the services rendered by BJ-Titan relate to real property, the cost of services provided are likewise non-taxable. Finally, the transfer of vehicles qualifies as an isolated or occasional sale; if not, then the Agency should be precluded from applying the entity test as it failed to follow required rulemaking procedures.

DATED this 4th day of March, 1991.

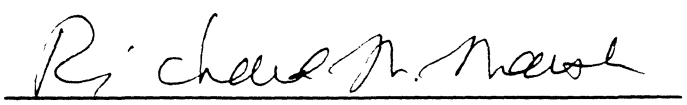
MAXWELL A. MILLER
RANDY M. GRIMSHAW
RICHARD M. MARSH
of and for
PARSONS BEHLE & LATIMER
Attorneys for Petitioner

MAILING CERTIFICATE

I hereby certify that I caused to be mailed, postage prepaid, true and correct copies of the foregoing REPLY BRIEF OF PETITIONER to the following on this 4th day of March, 1991:

James H. Rogers
Director, Auditing Division
Heber M. Wells Bldg.
Salt Lake City, Utah 84134

Brian Tarbet
Assistant Attorney General
130 State Capitol Building
Salt Lake City, Utah 84114



284/021991A